

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF NALEDI LOCAL MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Naledi Local Municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx]

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126 of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matter(s) discussed in the Basis for disclaimer of opinion paragraph(s), however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

3. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Basis for disclaimer of opinion

Fixed assets

4. Sufficient appropriate audit evidence could not be obtained as to the completeness, existence and valuation of fixed assets as disclosed in note 5 to the financial

statements amounting to R34 915 086 in the current year and R29 742 636 in the previous year, due to the following:

- a) Management did not ensure that a detailed fixed asset register agree to the summarised fixed asset register and the general ledger. A difference amounting to R495 383 was noted between the detailed and the summarized asset register. Furthermore, a difference of R646 431 was noted between the detailed fixed asset register and the general ledger. The entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence, valuation and completeness of fixed assets.
- b) I was unable to confirm the existence of vehicles to the value of R488 500. The vehicles included in the fixed asset register do not indicate the unique identification numbers such as the vehicle registration numbers. I was therefore unable to confirm by alternative means the existence of these vehicles.
- c) Debit and credit journal adjustments of R83 964 380 and R88 252 929, respectively, were recorded in the prior year without providing appropriate supporting documentation. Management could not provide explanations for these journal adjustments and the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for fixed assets and accumulated surplus.
- d) Supporting documentation could not be obtained for additions to fixed assets amounting to R23 276 680 in the current year and R8 973 655 in the previous year. Management does not ensure that all documentation is available for audit purposes. There were no alternative procedures that I could perform to obtain reasonable assurance as to the valuation of these fixed assets.
- e) Sufficient appropriate audit evidence could not be provided for the difference between the prior year closing balance as per financial statements and the current year opening balance in the general ledger in respect of fixed assets amounting to R3 210 685. Alternative audit procedures could not be performed to obtain reasonable assurance regarding the valuation of fixed assets in the financial statements.
- f) The council approved that assets amounting to R378 630 be written off in the previous financial year. Management could not provide supporting documentation as evidence that these assets were written off and removed from the asset register. I was unable to confirm by alternative means that these assets were written off. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for fixed assets and for accumulated surplus.
- g) Management could not submit supporting documentation for assets written off/transferred/redeemed/disposed in the prior year amounting to R73 716 208 as disclosed in appendix C of the previous year's financial statements. The entity's records did not permit the application of alternative audit procedures to confirm that these amounts were written off. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for fixed assets and for accumulated surplus.

- h) Management was unable to submit documentation for journal entries recorded against fixed assets amounting to R34 788 139. The entity's records did not permit the application of alternative audit procedures regarding the journals recorded against fixed assets. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for fixed assets, surplus for the year and accumulated surplus.
- i) Sundry assets were included in the asset register as a total amount of R536 009. No supporting documentation could be obtained that indicates the individual assets these amounts consist of. The entity's records did not permit the application of alternative audit procedures regarding these assets. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence of these fixed assets.
- j) Clinics to the value of R1 061 242 were not transferred to the Department of Health. Management did not adhere to the council resolution stipulating that clinics should be transferred to the provincial administration. I was unable to confirm or verify by alternative means that the title deeds were indeed transferred to the Department of Health. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for fixed assets and accumulated surplus.
- k) The existence of properties as included in the asset register to the value of R6 381 323 could not be confirmed, because the asset generic description of properties was not indicated. The entity's records did not permit the application of alternative audit procedures regarding these assets.

5. Fixed assets as recorded in the financial statements were not recognised in accordance with to the municipality's accounting policy which states that fixed assets are stated at *historical cost, or at valuation (based on the market price at date of acquisition), where assets have been acquired by grant or donation. While they are in existence and fit for use, except in case of bulk assets which are written off at the end of their estimated life as determined by the CFO and approved by Council*. The following discrepancies were noted:

- a) The Wepener swimming pool was physically verified and although not in a working condition, was still included in the fixed asset register which forms part of fixed assets as disclosed in the financial statements. The municipality did not perform periodic asset counts during the period under review. Had this asset been properly valued, fixed assets and accumulated surplus would have been reduced by R392 000.
- b) Assets disposed of were still included in the asset register which forms part of fixed assets as disclosed in the financial statements. Had these assets been excluded from the asset register, fixed assets would have been reduced and expenditure increased by R419 395.
- c) According to the Centlec asset register a vehicle valued at R142 736 was utilised in the Naledi area. This vehicle was registered in the name of Mangaung Local Municipality instead of Naledi local municipality as it was acquired with the funds of the Naledi Local municipality. Although the vehicle was registered in the name of Mangaung local municipality, it was also included in the register of the Naledi local municipality when consolidating

the financial statements. This matter was also reported in the 2006-07 financial year and has still not been corrected by management. Had this asset been removed from the asset register, fixed assets would have been reduced by R142 736 and receivables increased by R142 736.

- d) The value of the showgrounds property was indicated in the asset register of Naledi local municipality as R573 000. According to the valuation roll this is not the property of the municipality as it is registered in the name of a private firm. This is a result of management not reconciling the asset register and the valuation roll to ensure that only properties that belong to the municipality are included in the fixed asset register. Had these asset been removed from the asset register, fixed assets and accumulated surplus would have been reduced by R573 000.
- e) Assets to the value of R40 338 470 identified on the valuation roll could not be traced through to the asset register. Had these assets been included in the asset register, fixed assets and accumulated surplus would have been increased by R40 338 470.

6. The financial statements of Centlec indicates an amount of R992 301 for fixed assets while appendix C indicates an amount of R5 297 411 for assets and an amount of R3 971 803 in respect of loans redeemed and other capital receipts. The net fixed assets as recorded in appendix C only indicate an amount of R1 325 608, resulting in overstatement of fixed assets and accumulated surplus by an amount of R333 307.

Accumulated surplus or deficit

- 7. Management could not provide sufficient supporting documentation for journals amounting to R8 126 173 recorded against accumulated surplus. The entity's records did not permit the application of alternative audit procedures to confirm the journals recorded against this account. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness and valuation of accumulated surplus disclosed in the financial statements.
- 8. A prior year error relating to expenditure for the 2006-07 financial year that was paid and recorded during the 2007-08 financial year was incorrectly rectified by management. Accumulated surplus account was credited instead of debited. Management did not ensure that corrections made with regard to the prior year were accurately recorded and correct. Had this correction been made correctly, accumulated surplus would have been decreased by R168 590 and expenditure decreased by R168 590.
- 9. Revenue disclosed in the 2006-07 financial statements exceeded the revenue recorded in the general ledger by R3 674 730. No explanation could be obtained from management with regard to this difference for the prior year. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for accumulated surplus.
- 10. Management was unable to provide supporting documentation for a journal recorded in the 2006-07 financial year amounting to R949 568 between the

appropriation account and the sewerage equitable share account. The entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence and valuation of accumulated surplus disclosed in the financial statements.

Creditors

11. Audit assurance could not be obtained as to the existence, completeness, rights and obligations of creditors as disclosed on the balance sheet amounting to R12 185 211 for the current year and R10 234 209 in the previous year, due to the following:

- a) Sufficient appropriate evidence could not be provided for the difference between the prior year closing balance in the financial statements and the current year opening balance in the general ledger amounting to R2 755 151. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.
- b) Management was unable to provide supporting documentation in respect of journal entries recorded against the creditors account amounting to R3 395 229. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts recorded in the financial statements for creditors and the surplus for the year.
- c) Sufficient appropriate evidence could not be obtained for the difference amounting to R1 353 525 between the grants not utilised, as disclosed in the balance sheet, and unspent conditional grants as disclosed in note 27 of the financial statements. Explanations could also not be provided for the difference of R344 819 between the grants not utilised, as disclosed in the financial statements, and amounts recorded in the general ledger. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.
- d) Management could not provide explanations for the difference of R3 638 043 between the amount disclosed as creditors on the balance sheet and the supporting documentation provided. I was unable to confirm or verify by alternative means the carrying value of creditors included in the financial statements. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.
- e) Credit and debit journals entries amounting to R7 528 462 and R4 025 397 respectively were processed against creditor accounts in the 2006-07 financial year for which no sufficient appropriate documentation could be provided. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors and accumulated surplus.
- f) Management could not provide sufficient appropriate evidence for the difference of R2 774 311 between the creditor amounts as disclosed on the balance sheet and the amounts per general ledger for 2006-07 financial year. Explanations could also

not be provided for the difference of R52 165 between the trade creditor amount disclosed in the financial statements and the supporting creditor list. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors and accumulated surplus.

12. A recalculation was performed of creditors included in the creditors list that was disclosed in the financial statements. Creditors outstanding at year-end were incorrectly calculated, resulting in creditors and expenditure being understated by R500 990.
13. Creditors amounting to R597 007 were not disclosed in the financial statements at year-end, resulting in creditors and expenditure being understated by R597 007.
14. Receipts amounting to R4 226 870 were allocated to a creditor suspense account and disclosed under creditors in the financial statements. This amount should have been allocated against the debtor accounts, consequently creditors and debtors were overstated by R4 226 870.
15. In terms of section 65(2)(b)(i) of the MFMA, the accounting officer should, *inter alia*, ensure that all expenditure is recognised when incurred. Not all services rendered during the 2006-07 financial year had been accounted for. Management did not follow up and resolve this matter. As a result, creditors were understated and accumulated surplus overstated by R2 064 906.
16. Centlec's financial statements include an amount of R639 357 for the current year and R272 226 for the prior year as being receivable from Naledi, but not recorded as payable in Naledi's financial records. The nature and origin of this debtor are due to a net amount for the expenses incurred by Centlec on behalf of Naledi, and revenue received by Centlec on behalf of Naledi. Consequently, creditors were understated and accumulated surplus overstated by R639 357.
17. Centlec's financial statements indicate an amount of R529 215 for creditors in the financial statements. In preparing the financial statements for Naledi, an amount of R753 092 was included, resulting in a difference of R223 877. Due to management's unwillingness to adjust the error, creditors were overstated and accumulated surplus understated by R223 877.
18. Unspent conditional grants and receipts, as disclosed in note 27 to the financial statements, differ from the supporting schedules by the amount of R1 313 972. Management did not ensure that the supporting schedules to the financial statements agree with the notes to the financial statements. I was therefore unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.

Personnel expenditure

19. Due to lack of supporting documentation, it was not possible to obtain adequate audit assurance as to the occurrence, completeness, accuracy and classification of expenditure to the amount of R12 041 816 as disclosed in appendix D to the financial statements, due to the following:

- a) Management could not provide sufficient supporting documentation for journals to the amount of R9 570 814. The entity's records did not permit the application of alternative audit procedures.
- b) Supporting evidence relating to employee and employee-related costs to the amount of R2 628 302 could not be obtained. In the absence of adequate supporting documentation it was also not possible to perform alternative procedures.
- c) Management could not provide explanations for the difference of R1 516 090 between the salaries, wages and allowances disclosed in appendix D and the amount per general ledger. In the absence of adequate supporting documentation it was also not possible to perform alternative procedures.

20. Section 124(1)(c) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) stipulates that the notes to the annual financial statements of a municipality must include particulars of the salaries, allowances and benefits of the municipal manager, the chief financial officer, and every senior manager as well as categories of other officials as may be prescribed. The amounts disclosed in note 15 to the financial statements did not agree to the amounts recorded in the salary system. Management did not ensure that the amounts disclosed in the financial statements were compared to the amounts recorded in the salary system for correctness. The note to the financial statements was therefore understated by R339 687.

21. Section 125(a)(b) and (c) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) states: *The note to the financial statement of the municipality must include the total amount of contributions to organised local government for the financial year, and the amount of any contribution outstanding as at the end of the financial year; and the total amounts paid in audit fees, taxes, levies , duties and pension and medical aid contribution, and whether any amounts were outstanding as at the end of the financial year.* The total contributions for the year, the total amount paid and the amount outstanding at year-end for PAYE, UIF, SDL, medical aid and pension fund were not disclosed in the financial statements. The amount outstanding at year-end for PAYE, UIF and SDL was R97 072. The amounts declared and paid relating to pension totalled R925 727, and for medical aid R1 088 438. Therefore, the municipality did not comply with the MFMA.

Expenditure

22. Audit assurance could not be obtained as to the occurrence, completeness, accuracy and classification of expenditure as disclosed in the income statement amounting to R40 605 638 due to the following:

- a) Sufficient supporting documentation could not be provided for journal entries recorded against the expenditure accounts amounting to R5 832 504. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for expenditure.
- b) Sufficient supporting documentation could not be provided for expenditure transactions amounting to R592 294. The entity's records did not permit the application of alternative audit procedures.

- c) Individual loan agreements for capital purchases made by Centlec on behalf of the Naledi local municipality could not be obtained. I was unable to confirm or verify by alternative means the expenditure relating to long-term liabilities amounting to R224 460. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for expenditure, long-term liabilities, surplus for the year and accumulated surplus.
- d) A service agreement with the firm providing the services of chief financial officer could not be submitted by management. Payments amounting to R214 936 were made to this service provider during the financial year. The entity's records did not permit the application of alternative audit procedures.

23. Transactions amounting to R844 619 were incorrectly allocated as expenditure. Sufficient monitoring controls were not effected by management to ensure that transactions are correctly classified. Expenditure is overstated by R844 619, revenue is understated by R186 297, personnel expenditure is understated by R116 125, fixed assets is understated by R900 777 and creditors is overstated by R14 014.

24. Section 122(1) of the MFMA requires a municipality to prepare financial statements which, inter alia, fairly present the financial results and its financial position as at the end of the financial year. Expenditure of R4 453 798 incurred during the 2006-07 financial year had incorrectly been accounted for as expenditure for the 2007-08 financial year. Expenditure and accumulated surplus were consequently overstated by R4 453 798.

25. When the conditions of the conditional grant are met, the expenditure incurred is transferred to expenditure in the income statement and the revenue equal to the expenditure incurred during the financial year is recognised. The amount recognised as revenue in the income statement does not reconcile to the amount that should have been recognised in terms of the conditional grants accounts. Reconciliations are not performed between the expenditure and revenue recognised in the income statement and the conditional grant accounts. Consequently, revenue and expenditure are overstated by R1 171 436.

26. Centlec's financial statements indicate an amount of R6 895 163 in respect of expenditure. However, the amount included in the financial statements of Naledi local municipality is R7 243 685, with the difference of R348 522 resulting in overstatement of expenditure and accumulated surplus by R348 522.

Debtors

27. Audit assurance as to the existence, completeness, rights and obligations as well as valuation and allocation of debtors as disclosed in the balance sheet amounting to R29 336 881 in the current year and R17 281 187 in the previous year could not be confirmed due to the following:

- a) Management was unable to provide explanations for the variances identified between the annual financial statements and the source documents supporting the amounts as disclosed in the balance sheet. I was therefore unable to confirm or verify by alternative means the carrying value of debtors included in the financial statements. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors.

- i) A variance of R7 899 was identified between the debtor amount disclosed in the financial statements and the amount per general ledger.
- ii) The age analysis on 30 June 2008 and the debtor accounts in the general ledger differ by an amount of R483 187. Reconciliations were not performed between the debtor sub-ledger accounts and the general ledger.
- iii) The opening balance on the debtor accounts in the general ledger for the 2007-08 financial year and the closing balance on the debtor accounts in the general ledger for the 2006-07 financial year differ by an amount of R13 482.
- iv) Debtors as disclosed in the 2006-07 financial statements and the closing balance on the debtor accounts in the general ledger for the 2006-07 financial year differ by an amount of R725 475.

Due to the variances identified in the age analysis, the existence and valuation of debtors older than 90 days could not be verified. Thus the correctness of the provision for bad debts to the amount of R15 022 982 is doubtful. No evidence could be obtained that legal action had been taken to recover outstanding debtors; therefore the recoverability of debtors is also doubtful.

- b) No supporting documentation could be obtained in respect of the credit journals in the previous year amounting to R1 150 757. I was unable to confirm or verify by alternative means the carrying opening balance of debtors included in the financial statements. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors and accumulated surplus.
- c) Sufficient supporting documentation could not be provided in respect of journal entries recorded against debtor accounts amounting to R4 188 461 in the current year and R884 004 in the previous year. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors.
- d) Sufficient supporting documentation could not be provided in respect of unknown debtor accounts to the amount of R134 085 included in the age analysis at year-end. The entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence of these debtors.
- e) Sufficient appropriate audit evidence could not be obtained in respect of a variance to the amount of R4 247 808 between the amount disclosed in the financial statements for the 2005-06 financial year and the amount per general ledger. Due to lack of supporting documentation, I was unable to confirm or verify by alternative means the opening balance of debtors included in the financial statements. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors and accumulated surplus.
- f) Management could not provide explanations for the difference of R3 205 414 between the general ledger accounts for VAT and the VAT 201 reports for the month ended 30 June 2008. I was therefore unable to confirm or verify by alternative means the valuation of the VAT amounts that should be included under

debtors as disclosed in the balance sheet. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors and surplus for the period.

g) Supporting documentation could not be provided for the amount of R480 260 included under debtors in respect of VAT relating to Centlec. Confirmation or verification by alternative means could not be obtained. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors and surplus for the period.

28. Reticulation losses as reported in the prior year had not been followed up and resolved by management. These losses increased from R336 295 in the prior year to R1 874 896 in the current year. No indication could be obtained from the management of the municipality as to how the increase of 457% would be corrected.

29. Amounts recoverable from the employees and service providers totalling R270 548 were incorrectly disclosed as prepayments in the financial statements, resulting in overstatement of prepayments and understatement of debtors by R270 548.

30. Interest on outstanding debtor accounts was not levied for 11 months during the 2007-08 financial year, which is contrary to the stipulations of the municipal credit control policy. Had the interest been levied, debtors and income would have been increased by R4 521 317.

31. Receipts amounting to R424 702 in the prior year were not recorded and accounted for against the relevant debtor and revenue accounts. Due to prior year errors which had not been rectified, I was unable to confirm or verify by alternative means the opening balance of debtors included in the financial statements. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors and accumulated surplus. This was also reported in the previous financial year.

32. Discrepancies were reported in the prior year in respect of revenue not being recorded, duplication of journals, conditional grants not being utilised for their intended purpose, output VAT not declared on MIG grant and input VAT not claimed but not followed up and resolved by management. Due to these errors not being rectified, debtors and accumulated surplus were understated by R4 652 626.

33. Output VAT in the prior year was incorrectly debited by an amount of R677 439, resulting in overstatement of debtors and accumulated surplus. This was also reported in the previous financial year.

34. An amount of R161 911 receivable from SARS relating to the November 2007 VAT return was incorrectly allocated by SARS to the PAYE account and reflected as amount due by the municipality. A correcting journal entry was not passed between the VAT account and the PAYE account in the municipality's records. Due to lack of reconciliations between the records of the municipality and the records of SARS, debtors and creditors were overstated by R161 911.

35. Section 125(1)(c) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) states: *The notes to the financial statements of a municipality must include the total amounts paid in audit fees, taxes, levies, duties and pension and medical aid contributions, and whether any amounts were outstanding as at the end of the*

financial year. The balance outstanding as at the end of the financial year owed by SARS to the municipality regarding VAT amounting to R4 734 369 was not disclosed in the notes to the financial statements. The municipality did not comply with this section of the act.

36. Input VAT was always claimed incorrectly and in some instances not claimed at all although the municipality is entitled to claim from SARS. In these instances, the municipality did not comply with the provisions of the VAT Act, 1991 (Act No. 89 of 1991), consequently expenditure was understated and debtors overstated by R619 215.

Unauthorised expenditure

37. Unauthorised expenditure is defined in the MFMA as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3), and includes overspending of the total amount appropriated in the municipality's approved budget, overspending of the total amount appropriated for a vote in the approved budget, and expenditure from a vote unrelated to the department or functional area covered by the vote. An overspending of the total amount appropriated for a vote in the approved budget was realised by the municipality to the amount of R9 264 497. The overspending was in respect of community services and was not disclosed in the financial statements as required by section 125(2)(d) of the MFMA.

Commitments

38. Approved capital projects to the amount of R1 688 698, as disclosed in note 26 to the financial statements, were not complete and accurately valued. Projects amounting to R10 933 340 were identified in the list of contractors but not considered in determining the contractual obligations; consequently, commitments had been understated by R9 244 642.

Revenue

39. Fruitless and wasteful expenditure incurred in respect of interest paid to Bloemwater amounting to R1 096 554 was not disclosed as a note to the financial statements. Furthermore, the transaction was incorrectly recorded in the financial records as revenue instead of expenditure, resulting in revenue and expenditure being understated by R1 096 554.
40. The amount recorded in the municipal financial records in respect of prepaid electricity amount to R4 229 959 (excluding VAT). However, the total amount for the year indicated in Actaris (Cape Town) transaction files in respect of prepaid electricity sold is R4 069 541 (excluding VAT); consequently, revenue has been overstated and payables understated by R160 418.
41. An amount of R586 704 was received from the auctioneers for assets disposed of on an auction held on behalf of the municipality. This amount was recorded as profit on sales. This was actually the net amounts received and all of the amounts relating to this transaction were not recorded. As a result, expenditure was understated by R111 143, revenue was understated by R39 091 and debtors were overstated by R72 051.

42. Audit assurance as to the occurrence, completeness, accuracy and classification of revenue as disclosed in the income statement to the amount of R45 679 709 could not be obtained due to the following:

- a) Sufficient supporting documentation could not be provided in respect of journal entries recorded against revenue accounts amounting to R1 682 281. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for revenue.
- b) Manual water reading registers in respect of revenue collected for water usage to the amount of R390 228 could not be provided. The entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the occurrence, accuracy, and completeness of water income as disclosed in the income statement to the amount of R342 306.
- c) A complete list/register for rotating electricity meters registered in the Naledi district could not be provided. The entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of electricity income as disclosed in the income statement to the amount of R2 475 385.

Irregular expenditure

43. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality in contravention of, or not in accordance with, a requirement of this act, and which had not been condoned in terms of section 170; expenditure incurred by a municipality in contravention of, or not in accordance with, the requirement of the Municipal Systems Act and which had not been condoned in terms of the act; or expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the municipality's supply chain management policy, and which had not been condoned in terms of such policy or by-law. Irregular expenditure disclosed in note 19.1 to the financial statements was understated by R2 359 595 in the current and R1 899 257 in the prior year, due to the following:

- 44. Irregular expenditure to the amount of R294 000 was disclosed in note 19.1 to the financial statements. The amount disclosed in the note does not meet the definition of irregular expenditure as these expenses were in respect of unbudgeted expenditure. The expenditure should have been disclosed as unauthorised expenditure. The result was an overstatement of irregular expenditure and understatement of unauthorised expenditure by the same amount.
- 45. Irregular expenditure identified in the prior year audit amounting to R1 734 141 was not disclosed as irregular expenditure in the comparative figures of the financial statements as required by section 125(2)(d) of the MFMA.
- 46. Irregular expenditure to the amount of R2 653 595 was incurred due to supply chain management policy and supply chain management regulations not being adhered to.
- 47. Councillors' remuneration in the prior year was not paid in accordance with SALGA upper limits set in section 7 of the Remuneration of Public Office Bearers Act, 1998

(Act No. 20 of 1998), read with the *Government Notice R1125 of 14 November 2005* and *R653 of 30 June 2006*. The amount disclosed in note 16 to the financial statements in respect of prior year includes overpayments of R165 116, due to upper limits being exceeded. This matter was also reported in the previous financial year.

Fruitless and wasteful expenditure

48. Fruitless and wasteful expenditure is defined in the MFMA as expenditure that was made in vain and would have been avoided had reasonable care been exercised. The municipality incurred fruitless and wasteful expenditure amounting to R123 876 due to the following:
49. Remuneration was paid to the previous acting municipal manager until end of June 2008 to the amount of R123 876, although his contract had expired at the end of February 2008.
50. The municipality incurred overpayments and duplicate payments in the prior year to the amount of R209 353.

Long-term liabilities

51. Due to lack of sufficient appropriate audit evidence relating to individual loan agreements in respect of expenditure transactions for capital purchases by Centlec on behalf of Naledi Local Municipality, I was unable to confirm or verify by alternative means the carrying value of the long-term liabilities amounting to R879 176 in the current year and R992 301 in the prior year. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness, rights and obligations as well as the valuation and allocation of long term liabilities as disclosed on the balance sheet.

Cash and cash equivalents

52. Presented in the financial statements submitted by Centlec to Naledi local municipality is a bank overdraft of R647 042 in the current year and R277 500 in the prior year. These balances were not taken into account in the disclosure of cash and bank of R4 643 027 (2007: R2 579 450) on the balance sheet of the Naledi local municipality. Had these balances been included on the balance sheet, the bank overdraft would have been stated at R647 042 for the current year and R277 500 in the prior year. The accumulated surplus would have been reduced by the same amount.
53. According to section 64(2)(d) of the MFMA the accounting officer should ensure that all monies received by the municipality are promptly deposited into the municipality's primary bank account. Deposits of R106 541 indicated in the general ledger could not be traced to bank statements or outstanding deposits in the bank reconciliation of the prior year. Due lack of preparing bank reconciliations on a monthly basis, cash and cash equivalents in the prior year as disclosed on the balance sheet had been understated and the creditors suspense account overstated by R106 541.

Provisions

54. The leave records of the municipality and its records of work attendance were not reliable for purposes of establishing the accuracy and completeness of leave to the credit of officials at year-end. The leave records were therefore not a reliable basis for calculation of the provision for leave as included on the balance sheet and disclosed in note 12 to the financial statements. Therefore it was not possible to verify the correct valuation of the provision for leave amounting to R803 550. In the absence of reliable leave records it was also not possible to perform alternative procedures to accurately determine the value of the provision.

Leases

55. The municipality's accounting policy for leased assets states: *Fixed assets held under finance lease are capitalised. Such assets are effectively amortized over the term of the lease agreement. Finance charges are allocated to accounting period over the duration of the leases, by the effective interest rate method, which reflects the extent and cost of lease finance, utilised in each accounting period. All other leases are treated as operating leases and the relevant rentals are charged against the operating account in a systematic manner related to the period of use of the assets concerned.* The operating lease disclosed in note 9 to the financial statements relates to an agreement entered into in 2008-09 financial year. The agreement was signed on 20/06/2008 and the first instalment was paid in the 2008-09 financial year. Consequently, leases as disclosed on the balance sheet and in note 9 to the financial statements had been overstated by R505 296.

Inventory

56. The municipality's accounting policy for inventory states: *Inventory (stores and materials) is valued at the lower of cost, determined on the weighted average basis, and net realizable value.* Obsolete and redundant stock amounting to R182 972 noted during the physical count was not written off. This is as a result of council meetings not being held during the financial year. Consequently, inventory was overstated by R182 972, accumulated surplus overstated by R124 501 and expenditure understated by R58 471.

Financial statements

57. Section 122(1)(a) states: *Every municipality must for each financial year prepare annual financial statements which fairly represents the state of affairs of the municipality, its performance against budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.* The following discrepancies were noted in the presentation of the financial statements submitted by the management of the municipality:

58. The amount for current liabilities for the prior year as disclosed in note 13 to the financial statements did not agree to the amounts referenced to the note according to the balance sheet due to grants not utilised and other liabilities not included in the note to the amount of R2 129 605 and R1 031 854 respectively.
59. Budget deficit as disclosed in the income statement in respect of community services was overstated by R288 846 due to recorded budget figures not agreeing to the adjusted budget as approved by the council.

60. The comparative figure in respect of cash generated by operations in the cash flow statement did not agree to the amount recorded in note 20 to the financial statements. The cash flow statement reflects an amount of R5 318 865 and the note disclosed an amount of R2 688 856.
61. The comparative figure in respect of overdraft)/increase in cash on hand in the cash flow statement did not agree to the amount recorded in note 24 to the financial statements. The cash flow statement reflects an amount of R153 436 and the note disclosed an amount of R741 491.
62. The amounts in note 21 used to determine the increase/(decrease) in creditors in the prior year exclude grants not utilised and other liabilities amounting to R2 129 605 and R1 031 854 respectively. The increase/(decrease) in creditors as disclosed in the cash flow statement was therefore understated by R3 161 459.
63. The comparative amounts in note 16 to the financial statements did not agree with the signed prior year financial statements. The amount in respect of under/provision to the amount of R242 024 disclosed in the prior year was not included in the comparative figures.
64. Interest earned on the primary bank account amounting to R28 730 was not disclosed in note 17 to the financial statements. Furthermore, interest paid to Bloemwater amounting to R130 373 was also not disclosed.

Disclaimer of opinion

12. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Naledi Local Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters:

Going concern

65. The municipality experienced serious difficulties regarding debt collection and there was no evidence that the municipality had taken action to deal with the defaulters. Debtor days outstanding increased significantly from 294 days in the prior year to 817 days in the current year. The liquidity ratios decreased compared to the previous year and the municipality might not be in the position to meet its current obligations in the normal course of business. The average payment period also increased significantly from 247 days in the prior year to 379 days in the current year. The council did not have sufficient investments to cover funds and reserves. Accumulated funds, reserves and trust funds amounted to R42 091 355, while the external investments and bank balance amounted to R103 996 and R4 643 027 respectively, which is an indication that funds had been utilised for operating activities. The budget expenditure was exceeded during the financial year under review. The municipality utilised an overdraft facility for a period of five months during the financial year under review. In January 2008 the overdraft facility amounted to R1 978 518. Council approval for this overdraft facility could also not

be obtained. The provision for bad debts increased by 54% while creditors increased by 55%. Redundant stock was not written off at year-end, which could have resulted in a worse scenario reflected in the financial statements had these items been written off. The municipality was significantly dependent on the national and provincial government for its continued sustainability. This, along with other matters, points to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern.

Material inconsistencies in information included in the annual report

66. As disclosed in note 1.1 of the chief financial officer's report, the budget deficit for rates and general services amounted to R515 855. This was inconsistent with the budget deficit as disclosed in the income statement to the amount of R1 722 930.
67. As disclosed in note 3 of the chief financial officer's report, the comparative figure for current bank accounts amounted to R502 145. This is inconsistent with the comparative figure of R2 579 451 as disclosed on the balance sheet.

OTHER MATTER(S)

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

68. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed assets	X		X		X
Accumulated surplus or deficit					X
Creditors	X		X		X
Personnel expenditure			X		X
Expenditure	X		X		X
Debtors		X	X		X
Unauthorised expenditure	X				
Commitments					X
Revenue			X		X

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Irregular expenditure	X		X		X
Long-term liabilities			X		
Cash and cash equivalents			X		
Provisions			X		X
Leases	X				
Inventory					X
Financial statements	X				

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

Municipal Finance Management Act

69. Disposal of assets was not handled as stipulated in section 14 of the MFMA.
70. The budget file and documentation, with evidence of the revision process, could not be submitted to confirm compliance with section 53 of the MFMA.
71. No recovery plan could be obtained with regard to unauthorised, fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.
72. Contrary to section 62(1)(c)(i) of the MFMA, the municipality did not have a risk management policy in place. A risk assessment was last conducted in July 2005.
73. Reconciliations for revenue were not performed as required by section 64(2)(h) of the MFMA.

74. Contrary to the prescripts of section 65(2)(e) of the MFMA, numerous instances were identified where suppliers were not paid within 30 days and no proof could be obtained of any measures implemented to track the submission and payment of invoices to ensure compliance with this section of the MFMA.

75. The delegation of powers could not be submitted; consequently, I could not satisfy myself as to whether the municipality had complied with the stipulations of section 82 of the MFMA.

76. Declarations of interest could not be provided; consequently, I could not satisfy myself that the municipality had complied with the provisions of Supply Chain Management Regulations, 2005, 46(2)(c) and 46(3)(b).

77. Quotations were not obtained as required by Regulation 12(1) of the Municipal Supply Chain Management Regulations, 2005.

Municipal Systems Act

78. Contrary to sections 12 and 98 of the MSA, the municipality has not developed and adopted any by-laws.

79. Contrary to section 76(b) of the MSA, four service delivery agreements could not be submitted.

Municipal Structures Act

80. Contrary to section 37(c) of the MSA, minutes could not be submitted for all council meetings.

Division of Revenue Act

81. Although the municipality appropriates the Municipal Infrastructure Grant in its annual budget, the certificate required by section 11 of DORA could not be submitted.

82. Proof that the municipality certifies to National Treasury that each programme had been extensively appropriated and funded by this allocation in the annual budget, as required by section 11(2) of DoRA, could not be submitted.

Matters of governance

83. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X

Matter of governance	Yes	No
Internal audit		
<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. The internal audit function operates in terms of an approved internal audit plan. The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	X	X
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA. The annual report was submitted to the auditor for consideration prior to the date of the auditor's report. The financial statements submitted for audit were not subject to any material amendments resulting from the audit. No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management. The prior year's external audit recommendations have been substantially implemented. The Provincial SCOPA resolutions have been substantially implemented. 	X	X
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007. 		X
<ul style="list-style-type: none"> The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP. 		X
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008. 		X

Unaudited supplementary schedules

84. The supplementary information set out in pages xx to xx of the financial statements does not form part of the financial statements and is presented as additional information. I have not audited this schedule and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

85. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

86. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

87. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*, and section 45 of the MSA.

88. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

89. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

Non-compliance with regulatory requirements

No reporting of performance information

90. The municipality has not reported performance against predetermined objectives, as required by section 41 of MSA.

Review of performance management system

91. Proof could not be submitted that quarterly reviews were performed during the year under review and that the community was involved in the review process, as required by section 42 of the MSA.

92. The municipality has not established mechanisms to monitor and review its performance management system according to section 40 of the MSA.

Performance management system (PMS)

93. No proof could be obtained that the performance management system was adopted before or at the same time that the municipality commenced with the process of setting key performance indicators and targets in accordance with its integrated development plan, as stipulated by Regulation 8 of the Municipal Planning and Performance Management Regulations, 2001.

94. No proof could be obtained that the community was involved in the development, implementation and review of the PMS or that an appropriate forum was in place and that the community was involved in setting the KPIs as required by section 42 of the MSA.

Integrated development plan (IDP)

95. The IDP did not reflect the requirements as per section 26(h) of the MSA.
96. No input, output and outcome indicators were included in the IDP as required by section 41(1)(a) of the MSA and Regulation 9(1)(a) of the Municipal Planning and Performance Management Regulations, 2001.
97. The IDP review process plan for 2006-2011 was approved on 14 September 2006. However, it was not compiled timeously as required by section 28(1) of the MSA. The IDP review plan must be compiled within a prescribed period after the start of the elected term. The IDP review process was approved more than two years after the election.
98. The IDP was incomplete as it did not include targets per objectives as stipulated in section 41(1)(b) of the Municipal Systems Act.
99. No proof could be obtained that the municipality had given the public 14 days notice prior to the adoption of its integrated development plan, as stipulated in section 25(4)(a) of the MSA.
100. No proof could be obtained that a copy of the IDP was sent to the MEC for local government in the province within 10 days after the adoption of the plan, as prescribed by section 32(1)(a) of the MSA.

Service delivery budget implementation plan (SDBIP)

101. The municipality's service delivery and budget implementation plan (SDBIP) was not approved by the mayor within 28 days after the approval of the budget, as required by section 53(1)(c) of the MFMA. The SDBIP was only approved on 25 July 2007.

Budget

102. No developmental priorities and objectives were included in the municipality's 2007-08 budget, as required by Regulation 6(a) of the Municipal Planning and Performance Management Regulations, 2001.

Proper functioning of a performance audit committee

103. No performance audit committee was in place during the year under review as required by Regulation 14(3)(a) of the Municipal Planning and Performance Management Regulations, 2001.

APPRECIATION

104. The assistance rendered by the staff of the Naledi Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 January 2009

